

IRS News Release

Media Relations Office

Washington, D.C.

Media Contact: 202.622.4000

www.irs.gov/newsroom

Public Contact: 800.829.1040

National Taxpayer Advocate Delivers Report to Congress

IR-2008-4, Jan. 9, 2008

WASHINGTON — National Taxpayer Advocate Nina E. Olson today released her [annual report](#) to Congress, focusing particular attention on the consequences of changes to the tax code enacted late in the year and the need for a coordinated IRS approach to combat the cash economy portion of the tax gap. Olson also urged Congress to enact a Taxpayer Bill of Rights and to authorize symbolic “apology payments” in egregious cases where taxpayers suffer significant harm as a result of IRS errors. The report contains a second volume that describes the results of six research studies, including one that shows that low income taxpayers fare much better in IRS Earned Income Tax Credit audits when they are represented by practitioners.

Impact of Late-Year Tax Code Changes on Taxpayers

The report designated the frequency and magnitude of late-year changes to the tax code as the most serious problem facing taxpayers. In each of the last two years, Congress has acted in December to provide tax benefits with retroactive effect for the full year. In 2006, Congress extended several popular tax deductions. In 2007, Congress provided an Alternative Minimum Tax “patch” to protect approximately 20 million additional taxpayers from the AMT. The report notes that late action causes a variety of problems:

- More than a million taxpayers may not have claimed tax deductions to which they were entitled for 2006 simply because they did not know about them. The IRS publishes Form 1040 and its accompanying instructions in early November, and tax software companies finalize their shrink-wrapped software products around the same time. In 2006, Congress reauthorized deductions for state and local sales taxes, educator expenses, and post-secondary tuition and fees in December, and taxpayers made an estimated 1.4 million fewer claims for these benefits in 2006 than in 2005. The only discernable difference between the two years was that the benefits for 2006 were not included in the Form 1040 package or shrink-wrapped software. “When taxpayers do not claim tax benefits because they do not know about them,” Olson said, “Congress’s intent in providing the tax benefits is undermined and taxpayers understandably question the fairness of the tax system.”
- Low income taxpayers may experience financial hardship because their refunds are delayed. Most taxpayers who file returns are entitled to receive refunds, and the average refund for taxpayers who claim the earned income tax credit is more than \$3,000 – about 20 percent of their yearly income. The filing season normally starts round January 15, but the IRS had to delay the start of the filing season last year by three weeks for millions of taxpayers to enable it to reprogram its computer systems to

reflect the changes in law. As a consequence, the affected taxpayers had to wait an additional three weeks to receive their refunds. “For some taxpayers,” Olson wrote, “a delay of two to four weeks in receiving their refund could mean eviction, inability to pay the high heating bills that arise during winter, or defaulting on credit card bills from the holiday season.” The IRS recently stated that more than 13 million taxpayers may have to wait to file their returns until February 11 this year to allow the IRS to fully implement the changes Congress enacted last month.

- The IRS must divert its thinly stretched resources to implement the changes. Among other things, IRS computer systems must be reprogrammed to reflect changes, forms must be rewritten, new training materials must be developed for telephone assisters who answer tens of millions of taxpayer calls, and new instructions must be provided for volunteers who staff Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites. This additional work requires the IRS to pull personnel off other priority projects to effectively perform these tasks twice – once under the law as it existed for most of the year and a second time to incorporate late changes.

The report recommends that the Treasury Department and the tax-writing committees create a process through which IRS identifies and estimates the filing-season impact of significant tax legislation – particularly provisions extending existing benefits – are transmitted to the tax-writing committees at several points during the year, perhaps on June 30, September 30, and monthly thereafter.

Comprehensive Strategy Needed to Target “Cash Economy” Portion of Tax Gap

The report proposes a comprehensive strategy to address tax noncompliance in the cash economy, which accounts for the largest portion of the tax gap. The report stresses the need to identify new approaches to reduce the tax gap without imposing undue compliance burdens or undermining taxpayer rights. The report concludes that IRS’s current efforts are not adequately coordinated. “It is particularly disturbing that, for the third year running, the IRS declines to create a Cash Economy Program Office to coordinate its various initiatives,” Olson wrote. “*Ad hoc* measures will not get the job done.” The report identifies the lack of progress in addressing cash economy noncompliance as a most serious problem, makes recommendations for legislative change, and includes a research report that proposes a comprehensive set of administrative and legislative steps to address it.

Taxpayer Bill of Rights and Authorization of “Apology Payments”

The report urges Congress to enact a comprehensive Taxpayer Bill of Rights and to authorize “apology payments” in cases where the IRS excessively burdens or harms taxpayers. The U.S. tax system is based on a social contract between the government and its taxpayers, Olson wrote. Taxpayers agree to report and pay the taxes they owe and the government agrees to provide the service and oversight necessary to ensure that taxpayers can and will do so. Over the past two decades, Congress has enacted three significant taxpayer rights’ bills, but the number of bills and the lack of publicity have muddled the message, Olson said. “I believe taxpayers and tax administration will benefit from an explicit statement of what taxpayers have a right to expect from their government and what the government has a right to expect from its taxpayers,” Olson said.

The report notes that other tax systems, including the United Kingdom's and Australia's, authorize the tax administrator to make symbolic payments to taxpayers in cases where the tax administrator has made errors that imposed significant hardship or inconvenience. Such payments are *de minimis* – not designed to compensate the taxpayer for costs incurred but simply to acknowledge error in a tangible way. Olson recommended that Congress authorize up to \$1 million a year for the National Taxpayer Advocate to make such payments, which would range from \$100 to \$1,000.

Need for Better Taxpayer Guidance about Taxation of Canceled Debts

The report finds that many taxpayers may be paying taxes they don't owe because IRS instructions do not adequately explain exceptions to "cancellation of indebtedness" income. If a taxpayer borrows money and the debt is canceled, the taxpayer generally must include the amount of debt cancellation in gross income. This rule received significant attention in 2007 as homeowners who could not make their mortgage payments lost their homes to foreclosure and stood to receive tax bills for any amount of debt that exceeded the value of their property. While Congress passed legislation granting temporary relief relating to mortgages, taxpayers received about two million Forms 1099-C reporting canceled debts last year, many relating to defaults on automobiles and credit card bills.

There are several exceptions to the general rule that these amounts are taxable, including an exception that applies to the extent a taxpayer is insolvent (meaning the taxpayer's liabilities exceed the taxpayer's assets). In many if not most cases, the insolvency exception will shield canceled debts from gross income because affected taxpayers, almost by definition, are taxpayers who lack sufficient assets to cover their liabilities. However, IRS instructions do not explain the exceptions clearly. For example, the instructions to Form 1040 list canceled debts under the heading of "Examples of income to report" and make no mention of exceptions. As a consequence, many taxpayers who receive Forms 1099-C reporting canceled debts may include the amounts in income because they lack knowledge of the exceptions. "This is a significant shortcoming that must be addressed," Olson said. The report recommends that the IRS improve its instructions and develop a publication devoted to canceled-debt issues.

User Fees

In a section titled, "User Fees: Taxpayer Service for Sale," the report notes that the IRS collects about \$180 million in user fee receipts annually, mostly from the fee charged to taxpayers who enter into installment agreements to pay their tax liabilities over time. The Advocate's report expresses concern that the IRS does not have an adequate policy to determine what are core tax administration services for which no fees should be charged, to calculate the appropriate amount of a fee, and to provide a waiver of fees for low income taxpayers who cannot afford to pay them. If the IRS does not develop a clearer policy for setting and waiving fees, Olson said, "taxpayers' access to service may be reduced and their rights harmed as the IRS establishes new fees and raises others to make up for budgetary shortfalls." The report makes several recommendations to assist the IRS in establishing and setting fees in the future.

Status Update: Private Debt Collection Program

The report updates prior National Taxpayer Advocate reports on the private debt collection program. The report states that the program is falling far short of revenue projections. In May 2007, the IRS estimated that the program would raise gross revenue of between \$1.5 billion and \$2.2 billion over the next 10 years – with the midpoint of the range averaging \$185 million per year. The IRS now acknowledges that the program will not hit these targets. Gross revenue totaled \$31 million in FY 2007, is projected to be slightly less in FY 2008, and is not now projected to rise sharply in future years. To date, the costs of the program have exceeded the revenue the program has generated, and the IRS cannot project when the program will break even. Olson expressed particular concern about the lack of transparency in the program. IRS collection procedures are publicly available and subject to review by taxpayers and Members of Congress. By contrast, the private collection agencies have designated comparable information – including calling scripts and training materials – as proprietary, and the IRS to date has declined to insist on a contractual term to make them publicly available. As a consequence, the Advocate is prohibited from describing them in her reports to Congress, and the materials are not subject to public scrutiny. Olson reiterated her prior call for repeal of the program.

Research Studies

The National Taxpayer Advocate has repeatedly called on the IRS to expand its research program, and this year, her office has published six research reports in Volume 2 of the report that it conducted or commissioned. The Comprehensive Strategy for Addressing the Cash Economy proposes the establishment of a cash economy program office and includes a variety of recommendations, such as making compliance easier for taxpayers, improving income visibility, and improving the productivity of audits; a Study of the Role of Preparers in Taxpayer Compliance by Professor Leslie Book summarizes research already conducted on this issue and presents a roadmap of planned future study; the study on the expected effect of the Tax Increase and Prevention Reconciliation Act (TIPRA) on the IRS's offer in compromise program shows that most taxpayers do not have the resources to submit the newly required 20 percent deposit; the Earned Income Credit (EITC) Audit Challenges study details survey findings on taxpayer-reported barriers in the EITC audit process and concludes that represented taxpayers retain almost twice as much EITC benefits as their unrepresented counterparts; the Simulation of EIC Filing Behavior for the 2004 Hartford Case Study tests a contractor-developed agent-based model, predictive of taxpayer behavior, on a real life tax situation to determine the model's reliability and usefulness; and the Normative and Cognitive Aspects of Tax Compliance Literature Review, produced by Professor Marjorie Kornhauser, outlines numerous findings regarding the effect of personal values and social norms on taxpayer compliance.

Overall, the report discusses 29 problems facing taxpayers, makes dozens of recommendations for administrative change, proposes 11 recommendations for legislative change, and discusses the 10 tax issues most frequently litigated in the federal courts during the preceding fiscal year.

About the Taxpayer Advocate Service

The Taxpayer Advocate Service is an independent organization within the IRS that assists taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should. Taxpayers may be eligible for assistance if:

- They are experiencing economic harm or significant cost (including fees for professional representation);
- They have experienced a delay of more than 30 days to resolve a tax issue; or
- They have not received a response or resolution to their problem by the date promised by the IRS.

The service is free, confidential, tailored to meet taxpayers' needs, and available for businesses as well as individuals. There is at least one local taxpayer advocate in each state, the District of Columbia and Puerto Rico.

Taxpayers can contact the [Taxpayer Advocate Service](#) by calling the TAS toll-free case intake line at 1-877-777-4778 or TTY/TTD 1-800-829-4059 to determine whether they are eligible for assistance. They can also call or write to their local taxpayer advocate, whose phone number and address are listed in the local telephone directory and in Publication 1546, The Taxpayer Advocate Service of the IRS - How to Get Help With Unresolved Tax Problems, which is available on the IRS website at [IRS.gov](#).

Attachment: Executive Summary of 2007 Annual Report to Congress